

Internal Revenue Service

Number: **200834014**
Release Date: 8/22/2008
Index Number: 2601.03-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:
CC:PSI:B04
PLR-149338-07

Date:
May 02, 2008

LEGEND

Trust 4 =

Trust 5 =

Trust 6 =

Decedent =

Niece =

Niece 1 =

Trustee =

X =

Court =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear :

This responds to your letter dated April 15, 2008, and prior correspondence, submitted on your behalf by your authorized representative, concerning the income, estate, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of a trust.

FACTS

The facts and representations submitted are as follows. Decedent died on Date 1, prior to September 26, 1985. Pursuant to Item VIII, paragraph A of Decedent's will, the residue of Decedent's estate was divided into six separate equal parts, Trusts 1 through 6. Trusts 1, 2, and 3 are not the subject of this private letter ruling. Trust 4 was created for the benefit of Niece 1. Trust 5 was created for the benefit of Niece. Trust 6 was created the benefit of the children of Niece.

Under Item VIII, paragraph E of Decedent's will, upon the death of Niece 1, the principal of Trust 4 and any undistributed income would be paid over to the issue of Niece 1, in equal shares, per stirpes, or on default of such issue, the principal will be added to Trust 6 and administered in accordance with all the applicable provisions thereof. Niece 1 died on Date 2, leaving no issue.

Under Item VIII, paragraph F of Decedent's will, upon the death of Niece, the principal of Trust 5 and any undistributed income will be added to Trust 6 and distributed in accordance with all the applicable provisions thereof. Niece died on Date 4.

Under Item VIII, paragraph G of Decedent's will, until the termination of Trust 6, the net income is to be paid, not less often than quarterly, to the children of Niece who are living, and to the then living issue of any deceased child or children of Niece, all such payments of net income to be made in equal shares, per stirpes. The trustee may also pay to the income beneficiaries, from time to time, such amounts of principal as the trustee deems advisable for the proper maintenance, support, and education, taking into account such other income the beneficiaries receive from other sources. Trust 6 will terminate upon the expiration of 21 years from the date of the death of the last survivor of all the issue of Niece living at the time of Decedent's death. Upon termination of Trust 6, the principal will be distributed to the then living issue of Niece in equal shares, per stirpes.

The trustee of Trust 6 is Trustee, a bank. Trustee petitioned Court to amend Item VIII, paragraph G of Trust 6 to provide as follows:

The Trustee shall pay, distribute, or disburse, not less often than quarterly, to or for the benefit of the children of my niece, [Niece], who are living at the respective times of such distribution or disbursement, and to the then living issue of any deceased child or children of my said niece, in each calendar year of this Trust, an amount equal to [x] percent of the average of the fair market value of the Trust as of the close of the last business day of the Trust's three previous calendar years or the net income from such Trust, whichever is greater and is hereinafter referred to as the "distribution amount." All such payments of the distribution amount to be made in equal shares, per stirpes.

The amendment also gave Trustee the authority to petition Court to change the x percent distribution rate, in appropriate circumstances. Any such change must be

approved by Court. Further, no individual trustee has any authority to determine if the rate shall be changed. All computations of fair market value will include accounting income and principal, but no accruals are required. If the trust includes assets for which there is not a ready market, the trustee will adopt a method of evaluation as the trustee deems reasonable in its discretion under the circumstances. The distribution amount is to be paid first from net accounting income, next from net realized short-term capital gains, then from net realized long-term capital gains and, as necessary, from principal.

On Date 3, Court approved the modification of Item VIII, paragraph G of Trust 6, contingent on the issuance by the Internal Revenue Service (Service) of a favorable private letter ruling with respect to the GST tax consequences of the proposed amendment. On Date 5, the Service issued a ruling to Trustee that the modification of Item VIII, paragraph G of Trust 6 would not cause Trust 6 to lose its exempt status for GST tax purposes.

The current beneficiaries of Trust 6 are the four children of Niece. Trustee further represents that the current beneficiaries have differing investment goals and personal and financial situations and, as a result, desire to divide the trust to allow the trustee to tailor the investment objectives in line with the goals and financial situations of the beneficiaries of the separate resulting trusts. With the consent of the beneficiaries of Trust 6, Trustee petitioned Court to divide Trust 6 into four separate and equal trusts, one for the benefit of each child of Niece.

On Date 6, Court approved the division of Trust 6 into four separate resulting trusts, contingent on the issuance by the Service of a favorable private letter ruling with respect to the income, estate, gift, and GST tax consequences of the proposed division of Trust 6.

Pursuant to Court's Order, Trustee will divide Trust 6 on a pro rata basis into four separate resulting trusts. The distribution provisions of each resulting trust will be identical to the distribution provisions of Trust 6, except that the beneficiaries of each trust will be limited to the respective child of Niece or the child's issue for whom that trust is set aside.

Pursuant to Court's Order, each resulting trust will terminate twenty-one years after the death of the last to die of all of the children of Niece, provided that if at any time prior to this date a child of Niece dies and there are no surviving issue, that child's trust will be divided equally and added to the remaining trusts and administered and distributed as part of each of the other trusts that do have issue then living. In all other respects, the terms of the resulting trusts will be identical to those of Trust 6.

It is represented that Trust 6 was irrevocable on September 25, 1985 and that there have been no additions to Trust 6, actual or constructive, after that date other than

provided for in Decedent's will.

You request the following rulings:

1. The division of Trust 6 into four equal resulting trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not cause Trust 6 or the four resulting trusts to lose their grandfathered status for generation-skipping transfer tax purposes under § 2601 and will not cause a distribution from, or termination of any interest in, Trust 6 or any of the four resulting trusts to be subject to the GST tax.
2. The resulting trusts will be treated as separate taxpayers for federal income tax purposes pursuant to § 643(f).
3. The division of Trust 6 into four equal resulting trusts and pro rata allocation of each Trust 6 asset to the four resulting trusts will not be considered a distribution under § 661 or § 1.661(a)-2(f) of the Income Tax Regulations and will not result in the realization by Trust 6, the resulting trusts, or a beneficiary of Trust 6 or the resulting trusts of any income, gain or loss under § 61 or § 1001.
4. The division of Trust 6 into four equal resulting trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will result in the four resulting trusts holding assets with the same basis they had at the time of the division under § 1015 and holding periods for all the assets allocated to each resulting trust that include Trust 6's holding period under § 1223.
5. The division of Trust 6 into four equal resulting trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not cause any portion of the assets of Trust 6 or the resulting trusts to be includible in the gross estate of any beneficiary of Trust 6 or the four resulting trusts under §§ 2036, 2037, or 2038.
6. The division of Trust 6 into four equal resulting trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not constitute a transfer by any beneficiary of Trust 6 or the four resulting trusts that will be subject to gift tax under § 2501.

Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under

§ 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation in which, in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person

or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the present case, it is represented that Trust 6 is exempt from GST tax under § 26.2601-1(b)(1) because the trust was irrevocable on September 25, 1985. It is represented that there were no additions, actual or constructive, made to Trust 6. In particular, any additions made to Trust 6 pursuant to Item VIII, paragraphs E and F of Decedent's will do not constitute post-September 25, 1985, additions to Trust 6 because the additions were from trusts established under Decedent's will and such trusts were irrevocable on September 25, 1985. See § 26.2601-1(b)(5)(i).

We conclude that the proposed division of Trust 6 will not result in a shift of any beneficial interest in Trust 6 to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interest prior to the division and will not extend the time for vesting of any beneficial interest beyond the period provided for in Trust 6. Accordingly, based upon the facts and representations submitted, we conclude that the division of Trust 6 into four separate equal trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not cause Trust 6 or any of the four resulting subtrusts to lose their exempt status for GST tax purposes under § 2601 and will not cause a distribution from, or termination of any interest in, Trust 6, or any of the four resulting trusts to be subject to GST tax.

Ruling 2

Section 643(f) provides that, for purposes of subchapter J, under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1.

Section 1806(b) of the Tax Reform Act of 1986 provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust which was irrevocable on March 1, 1984, it shall apply only to that portion of the trust which is attributable to contributions to corpus after March 1, 1984.

Based on the facts and representations submitted, we conclude that as long as the four resulting trusts created by the division of Trust are each separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

Ruling 3

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Section 1001(c) provides that, except as otherwise provided, the entire amount of the gain or loss on the sale or exchange of property is recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are "materially different." Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applied) for the sum of (1) the amount of income for such taxable year required to be distributed currently and (2) any other amounts properly paid or credited or required to be distributed for such taxable year.

Section 1.661(a)-2(f) provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661) the sum of the following amounts: (1) the

amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid credited, or required to be distributed to such beneficiary for the taxable year.

Based on the information and representations submitted, the proposed division of Trust 6 on a pro rata basis into four separate resulting trusts will not cause the interests of the beneficiaries to differ materially. The beneficiaries will hold essentially the same interests before and after the pro rata division. Accordingly, the proposed division of Trust 6 and the distribution of the assets of Trust 6 among the resulting trusts will not cause the trusts or the beneficiaries to recognize any gain or loss from a sale or other disposition of property under §§ 61 and 1001. Based on the information and representations submitted, we conclude that the division of Trust 6 into the four resulting trusts is not a distribution under § 661 or § 1.661(a)-2(f). Further, we conclude that the proposed division of Trust 6 on a pro rata basis into four resulting trusts will not cause the interests of the trust beneficiaries to differ materially. The trust beneficiaries will hold essentially the same interests before and after the pro rata division. Accordingly, the proposed division of Trust 6 and the distribution of assets among the four resulting trusts will not cause the beneficiaries to recognize any gain or loss from a disposition of property under § 662.

Ruling 4

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased by the amount of gain or decreased by the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee or the beneficiary and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included in the period for which such property was held by any other person if, under Chapter 1 of the Code, the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of that other person.

Based on the facts and representations submitted, we conclude that the tax basis of the assets of the resulting trusts will be the same as the tax basis of Trust 6 in such assets. Accordingly, under § 1223(2) the holding period of the property received by the resulting trusts from Trust 6 will include the holding period of Trust 6 in such property.

Ruling 5

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period on the date of the decedent's death.

In this case, based on the facts and representations submitted, the proposed division of Trust 6 does not constitute a transfer within the meaning of §§ 2036, 2037, and 2038. Accordingly, we conclude that the proposed division of Trust 6 into the four resulting

trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not cause any portion of the assets of Trust 6 or any of the resulting trusts to be includible in the gross estate of any beneficiary of Trust 6 or the four resulting trusts under §§ 2036, 2037, or § 2038.

Ruling 6

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511(a) provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

In this case, upon the division of Trust 6 into four resulting trusts, the beneficiaries the resulting trusts will have substantially the same beneficial interests as they had under Trust 6 prior to the division. Because the beneficial interests are substantially the same both before and after the proposed division and modification of Trust 6, no beneficiary will be treated as making a transfer. Accordingly, based on the facts and representations submitted, we conclude that the proposed division of Trust 6 into the four resulting trusts and the pro rata allocation of each Trust 6 asset to the four resulting trusts will not constitute a transfer by any beneficiary of Trust 6 or the four resulting trusts that will be subject to gift tax under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
(Passthroughs & Special Industries)

Enclosures:

Copy for § 6110 purposes